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PRE-PACKAGEDINSOLVENCY– A MUCH NEEDED VALUE ADDITION TO IBC 2016

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ABSTRACT

Pre-Packaged Insolvency is apopular tool/process to pursue corporate bankruptcy in US, UK & other advanced economies. At present it is also gaining lot attention in India, particularly after the central government announced a one year moratorium on initiating fresh cases under CIRP basis section 7,9 &10 of IBC 2016.This article provides a detailed understanding, context& important concepts about Pre-Packaged Insolvency. It further explains the reason, rationale & need for having Pre-Pack in India, especially since there are no alternative tool available for out of court debt settlement/restructuring in this country.It alsoexplainshow Pre-Pack insolvency, as an important tool for informal debt settlement, can also work alongside the current CIRP process under IBC. In a way, this article is a first of its kind comprehensive review &need analysis of informal insolvency process in India. Lastly, the article also provides a short preview of Pre-Pack bankruptcy process as prevalent in UK & US.

KEYWORDS: *Cirp; Pre-Pack; Ibc; Nclt; Aa ; Jlf ; Ppirp; Pas ; Pairp;*
JEL: G33

INTRODUCTION

In the aftermath of recent announcement by central govt to suspend the new IBC process for next 12 month, due to COVD19, there has been several demand from industry & business associations in India to initiate alternative or out of court settlement mechanism to resolve long pending cases currently stuck with CIRP (IBC) without any resolution. The Insolvency law Committee, Feb, 2020 discussed about out of court settlement mechanisms and opined that for effectively rehabilitating the debtors it was necessary that court lead formal processes be supplemented with informal process. Hence, it agreed that regulatory authorities under the code may undertake steps to develop infrastructure that aid debtors in effectively utilizing mechanisms such as debt settlement, mediations and debt counselling. Matter of fact the interim bankruptcy law reforms committee, 2015 in its report debated on the viability of pre-packs as one of the methods of mediation in India. However, it was opined that the Indian market is currently not sufficiently developed so as to allow sales without intervention by any duly recognized legal authority/courts/NCLT etc. Although, the report pointed out the possibility of allowing such arrangements only after getting approved by NCLT within 30 days of filing.

Even prior to this, issues like, burgeoning IBC cases with NCLT,s, unusual delay in resolution, increase in CIRP cost, fear of adversarial ownership of company leading to disruption of going concern, impact on business due to moratorium & the change of management post CIRP initiation, were becoming matter of great concern to business owners, industry representatives & other stakeholders. This is precisely the reason why, there had been a strong demand for an alternative/ informal dispute resolution mechanism which could be initiated with full legal sanction & authority, even before formally initiating the corporate insolvency resolution process (CIRP) under IBC.

While the enactment of IBC in 2016, has ensured resolution& closure of many outstanding corporate default cases, yet the overall success rate is much less than desired. Hence a need has always been felt for an out of court /alternative resolution mechanism to resolve corporate default cases expeditiously with much lessor cost. In this reference post recommendation from Insolvency Law Committee report 2018, 12 A of IBC 2016, was added which provides an opportunity to withdraw/close CIRP post settlement or deal structuring with debtor or creditor.

The current discussion paper is structured into six part, starting with 1) Introduction to the subject 2) Review of Literature 3) Background & context of research 4) Discussion & Key Findings 5) Conclusions 6) Reference

2) Review of Literature

There have been multiple studies emphasizing role of private negotiation & out of court settlement of debt contract in reducing financial distress. As per Edith S. Hotchkiss & et al(ed) (4) " with a single lender, complete contracting and symmetric information, the efficient method of resolving financial distress would be a private restructuring of debt contract. Private mechanisms to restructure a financially distressed firm is expected to be less costly than formal bankruptcy proceedings. As The greater are the cost savings, the greater are claim holders' incentives to settle privately. Jose M. Garrido (6) in a world bank sponsored study, writes, " Informal restructuring can help preserve the business value of debtor enterprises and the interests of other stakeholders, to the benefit of creditors as a whole. The World Bank Principles and the UNCITRAL Legislative Guide, have also highlighted the importance of informal arrangements for restructuring. Both texts treat informal debt restructuring as an integral part of an efficient creditor-debtor regulatory system. As per S C Gilson (15), whether financial distress is resolved through bankruptcy or private renegotiation depends on whether stockholders and creditors will collectively benefit from settling out of court when private renegotiation generates lower costs than through bankruptcy. Under the lower-cost alternative, the resulting value of firm will be higher, and the firm's claims can be restructured on terms that leave each of the original claimholders (creditors) better off. Claim holders' incentives to settle privately will increase with the size of the potential cost savings from re-contracting outside of Chapter 11/formal insolvency process. As per study done by Stuart C Gilson (15) financial distress is more likely to be resolved through private renegotiation when more of the firm's assets are intangible, and relatively more debt is owed to banks; private renegotiation is less likely to succeed when there are more distinct /diverse classes of debt outstanding. The study by Stuart C Gilson(15) further finds that insolvent firms with relatively high going-concern value are more likely to restructure their debt privately, because more of this value tends to be lost for a variety of reasons (including through asset sales) when debt and the firm's operations are put to bankruptcy process through Chapter 11(formal bankruptcy) process. In view of many such studies, concerns & apprehensions associated with formal bankruptcy process (like IBC/Chapter11etc), the Bankruptcy Law Reforms Committee (BLRC) extensively discussed the viability of Pre-packs and opined that the Indian market is not developed enough to allow out of court restructuring, without intervention from NCLT/formal legal authority. However, NCLT's decision to allow an out of court settlement in the case of Binani Cements Ltd Vs Bank of Baroda and another, added fuel to the fiery debate on Pre-packs.

This decision which was stayed by NCLAT, (the appeal court) was finally upheld by the Supreme Court. The Insolvency law Committee, in Feb, 2020 discussed about out of court settlement mechanisms and opined that for effectively rehabilitating the debtors it was necessary that court lead formal processes be supplemented with informal restructuring process. Further, in the case, Lokhandwala Kataria Constructions Pvt Ltd Vs Nisus Finance and Investment Managers LLP, the Supreme Court used its power under Article 142 of the Constitution to give its approval for out of court settlement for the benefit of all the stakeholders and for meeting the ends of justice. Similarly in the case of Uttara Foods & Feeds private Ltd *Vs Mona Pharmachem, 2017,* Supreme Court observed that to avert unnecessary appeals, amendments should be made to the relevant rules to allow withdrawal of petition after its admission in case the parties settle outside the court. Apart from these, multiple literature in India points to the immediate need for informal debt resolution process. In her research paper, Sanjana Rao (10) opines, " in the present situation of NPAs with which the financial sector is stranded, pre-packs may prove to be a useful tool to aid the IBC process. In another study, Himani Singh (5) recommends Pre-Pack under a controlled regulatory environment before a full-fledged plan can be rolled out. Hence looking at the various academic references, NCLT / Supreme court judgements apart from recommendations from various govt commissions as also the demand from different stakeholders in India, there is an urgent need for exploring a credible, informal &hybrid debt restructuring process like Pre -Pack.

3) Background & context of this study

Prior to IBC, there was a process of negotiation, restructuring & management of debt of companies, via Corporate debt restructuring (CDR), Sustainable restructuring of stressed assets (S4A) Strategic Debt Restructuring(SDR), Flexible Restructuring of existing Term Project Loans along with the platform of Joint Lenders Forum(JLF) was available before initiating any legal action through SARFAESI,DRT or court cases etc. But due to its failure in achieving productive & sustainable debt resolutions, while at the same time increasing the NPA size in banks the RBI withdrew all the above scheme along with disbanding the Joint Lenders Forum (JLF) after the passing of IBC 2016. Hence IBC became virtually the single credible process of debt resolution /restructuring with no scope of any out of court settlement.

As per the current IBC provision, any informal process of debt restructuring was dependent on the right to close or stop or withdraw the ongoing CIRP under section 12 a of IBC 2016, if a resolution in this regard is approved by Committee of Creditors with 90 % voting right. Apart from this only an exclusive constitutional power of Supreme Court under article 142 of constitution allows any possibility of outside court /informal settlement of court /NCLT cases so as to complete the process of justice.

Section 12A of IBC 2016

"The Adjudicating Authority may allow the withdrawal of application admitted under section 7 or section 9 or section 10, on an application made by the applicant with the approval of ninety percent voting share of the committee of creditors, in such manner as may be prescribed".

Reality : The complication involved in the entire process of withdrawal makes it unpopular. First, RP has to initiate the proposal with COC, which needs to approve it by 90% vote, later adjudicating authority (AA) has to approve the resolution for withdrawal of case under section 7, Section 9 & section 10 of IBC 2016.

It is clear that initiating a withdrawal of CIRP as well as initiating an informal debt restructuring was very difficult and complicated.

Supreme Court, in its decision in Lokhandwala Kataria Construction (P) Ltd. V. Nisus Finance and Investment Managers LLP allowed a settlement between the parties after the application was admitted even though the NCLT rules expressly prohibit the same. Recently, the NCLT-Kolkata

Bench suggested an out of court settlement in the matter of Binani Cements insolvency. This incident sparked a debate on whether insolvency can be resolved through methods other than the formal Court-driven CIRP. The Supreme Court has allowed the out of court settlement bid to be considered by the committee of creditors along with other bids.

3.1) The Current scenario in debt restructuring & resolution

Until 2016, the stressed asset resolution process in India consisted of several tailor-made schemes such JLF (Joint Lenders Forum), CDR (Corporate Debt Restructuring) and SDR (Strategic Debt Restructuring), etc. The Reserve Bank of India withdrew these schemes in February 2018 after IBC became functional.

Post IBC the corporate debt resolution processes has been initiated through filing application by corporate debtors, financial & operational creditors in the National Company Law Tribunal (NCLT).The entire process is handled by an independently appointed & certified Insolvency Resolution Professional (IRP). Within maximum 330 days either a resolution happens or the process of liquidation is initiated.

While IBC's implementation has shown positive results, however, a detailed look of CIRP process corroborate that there have been more liquidations than successful restructurings. Between January 2017 and September 2019, 2542 companies have been admitted to undergo CIRP. Of this, the CIRP resolution plan has been approved for only 156 debtors; 587 debtors have been liquidated and the rest have withdrawn the application. Further, out of 1497 cases still under CIRP, 35% have exceeded the time prescribed to wrap up the resolution process under IBC.

As per report by rating agency CARE, of the total 3,774 cases admitted into Corporate Insolvency Resolution Processes (CIRPs) till the end of March 2020, 914 ended into liquidation, which is 24 per cent of the total cases admitted, On the other hand, only 6 per cent of the total cases were resolved. While 57 per cent of the cases still remain in the resolution process, others have either been closed or have been withdrawn.

Though IBC has had a positive effect on promoters of defaulting companies in terms of repayment discipline, yet liquidation is a grave threat perceived as failure of CIRP, and frequent instances of liquidation may not be a viable or desirable solution in the long run in terms of promoting the business culture in India. Time and costs, even for big companies undergoing CIRP, are huge factors which create an aversion towards CIRP.

3.2) The benefit & strength of IBCwhich has turned as negative

The Insolvency & Bankruptcy Code 2016 has been widely hailed by bankers, businessmen & economists as a much needed measure to ensure speedy resolution of debts as well as maximization of enterprise value. Last four year of successful operation has ensure unlocking of huge corporate debt, adding substantial cash flow to banks as well as ensure best possible enterprise value for corporate debtors. Till December 2019, the bankruptcy tribunal has admitted 3,254 companies for resolution under IBC. Of this, resolution plans have been approved for 190 cases, 246 cases have been closed on appeal or review and 780 cases are headed for liquidation.

While the success of IBC hinged on some of the following features & strength, but the actual outcome proved otherwise.

3.2.1) Time bound resolution

This is the best feature of IBC, wherein every cases needs to be completed within stipulated time period. All the cases need to be completed with 180 days, on request 90 days extension can be given after which additional 60 days extension was available. Hence within 330 days any CIRP case had to be completed.

Reality: Matter of fact most cases take almost 1.5 - 2 year years for resolution.

3.2.2) Lessor cost involved

Due to time bound & specified process, it was expected that IBC proceeding would involve much lessor cost.

Reality : Due to unusual delay i.e sometime due to genuine issues but mostly due legal & procedural delay indulged by corporate debtor, the process gets delayed and cost escalated multifold. The entire CIRP cost involving so many sub categories i.e IRP, CA,s, Valuation, stationary & other misc cost apart from lawyer and liquidation cost made the total cost many fold higher than expected.

3.2.3) Fair opportunity to all players in dispute

Due to involvement of judiciary & legal process, it was expected that entire CIRP process would be fair all parties and accordingly would provide equal opportunity corporate debtor, Financial creditor & Operational creditor etc.

Reality : The fact is entire IBC process is structured in favour of creditor in control (CIC) regime even at the cost of going concern concept. Hence most cases turn out against corporate debtor and in favour of liquidation of businesses mostly against the long term interest of corporate debtor & going concern.

3.2.4) Ensure right value for enterprise

It was assumed that IBC would ensure win win solution for all parties to the dispute i.e 1) Creditor would get back their maximum loan amount 2) Corporate debtor would get fair market value through liquidation of asset or change of ownership to ensure going concern is maintained.

Reality: CIRP process was hardly able to satisfy any party to the dispute. Liquidation value hardly went beyond 1% of realizable value ,while hunt for new buyer was never easy and in most cases it resulted in drastic hair cut in enterprise value.

3.2.5) Ensure business continuity

CIRP was designed to ensure business continuity & smooth transition through resolution via new bidding/change of ownership.

Reality: Post initiation of CIRP & issuance of notice, the management/board of Corporate debtor is suspended and day to day process taken over by IRP till completion of resolution process. Subsequently, notice of moritorium is issued issued banning sale / purchase of asset & any large business transaction affecting net worth etc. All these lead to delay, disruption in normal business activity of corporate debtor hence permanently damaging the business.

3.3) Why the need for alternative /informal debt resolution mechanism ?

The adverse nature & outcome of CIRP process as regards the going concern value objective of an enterprise makes it clear that the purpose and objective behind enactment of IBC was never fully realized and hence there was a need for an alternative resolution process, which would complement and strengthen the entire CIRP process along with successful resolution. While CIRP envisaged under the Code involves enormous participation of the adjudicating authority/ tribunals, yet it leaves minimal scope for any out of court settlement in the ongoing insolvency process. Such an approach has is based under the notion that the Indian market is not fully matured for an informal bankruptcy resolution process. This approach is in stark contrast to countries such as UK, U.S.A where bankruptcy resolution through out of court procedures is popular & hence practiced widely. In this regard, U.S.A and many other jurisdictions have also recognized a semi-informal arrangement known as pre-packaged bankruptcy or pre-pack. India having a preponderance of informal or proprietory businesses, has strong comfort & inclination

for a similar semi- formal debt resolution mechanism like Pre Pack. Accordingly, there is an urgent need to initiate similar arrangement in India as an integral part of IBC mechanism so that the entire CIRP process becomes smooth, less time consuming and provides optimum outcome for business.

4) DISCUSSION

4.1) The viability &context of Pre-Pack in India

The viability of Pre-packs in India has been debated extensively by the Bankruptcy Law Reforms Committee (BLRC) and it has been opined that the Indian market is not developed enough to allow out of court restructuring, without intervention from NCLT. However, NCLT's decision to allow an out of court settlement in the case of Binani Cements Vs Bank of Baroda & another case, generated huge interest / debate on Pre-packs. This decision, which was stayed by NCLAT was finally upheld by Supreme Court. However, the report by BLRC has pointed out that such a method can be allowed if it is mandated to get approval from the NCLT within 30 days of filing.

In the infamous bankruptcy of Essar Steel Ltd. Essar raised an objection that a CIRP application should not be admitted against Essar because the company was already involved in restructuring discussions with its lenders and pleaded for additional time to complete its debt restructuring. NCLT rejected this objection and stated that commencement of CIRP does not require ongoing restructuring discussions with lenders to be abandoned as they could form the basis of a resolution plan under IBC later. It seems that the CIRP is broad enough to include within its ambit the possibility of negotiating a resolution plan as a Pre-pack.

In this reference it would be worth considering 'Project Sashakt' an initiative introduced by the central government, as a precursor to introduction of Pre-packs in India. "Project Sashakt "suggested an approach of bringing together banks and financial institutions dealing with stressed assets by way of an inter-creditor agreement. The resolution approach to be adopted in respect of the assets is based on the size of the stressed asset enabling a better price discovery and quicker turnaround of assets. Failing completion of the resolution in 180 days, the stressed assets would be subject to CIRP under IBC.

Evaluating Pre-packs in terms of Project Sashakt, there is a similarity i.e in both the cases,the terms of debt restructuring would be formulated prior to filing an application for initiating legal or court cases/CIRP (under IBC). In furtherance of the finalized terms of Pre-pack, a CIRP application would be filed by the debtor and the Pre-pack plan promptly implemented as a resolution plan under the IBC.

The "Pre-pack" process, can work along the lines of CIRP, with creditor or potential investors involvement under court monitoring. However, being less formal than CIRP, Pre-pack can be concluded by obtaining a consent from creditor without undergoing a 180-day process stipulated for CIRP. If a Pre-pack is initiated along with the compliance of existing procedure/ processes prescribed under IBC, it would be NCLT's sole discretion, whether to re-open a Pre-pack on being approached by a dissenting creditor.

4.2} Pre-Packaged Insolvency/Bankruptcy – Concept& Background

Corporate rescue, as the term suggests, focuses on restoring the status of a distressed company. Pre-packs, largely perceived as a subset of corporate rescue, are typically employed to preserve the business of the Debtor Company, i.e., its trade able or enterprise value. The purpose of a pre-pack is to strike a balance between safeguarding the interests of the creditors and maintaining the business and assets of the debtor company by facilitating a swift transition of such assets and business.

In a pre-pack, "a troubled company and its creditors conclude an agreement in advance of any punitive legal procedure" which "allows legal procedures to be implemented at maximum

speed." Pre-packaged administration of insolvency , or 'pre-packs' as commonly referred to, is a mode of corporate rescue, relatively unknown to Indian market. A pre-packaged administration has been defined as 'an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser/investor/ creditor prior to the appointment ofInsolvency resolution professional(IRP)and & filing of bankruptcy petition. Black's Law Dictionary defines a 'pre-pack bankruptcy' as, 'Bankruptcy where the debtor agrees to terms reducing the time it takes to handle the business at hand.

The practice of pre-packs was first developed in the USA, following the enactment of the Bankruptcy Reform Act of 1978. Soon, it became so widely popular that in 1993, nearly one-fifth of all public bankruptcies were pre-packaged. Essentially, a pre-pack involves the filing of a re-organization plan along with the bankruptcy petition itself. The plan is "negotiated, circulated to creditors, and voted on before the case is filed". In some cases however,while the plan is negotiated and circulated to the creditors to obtain their in-principle approval prior to the bankruptcy filing, the formal voting process takes place after the bankruptcy filing. This is called a 'pre-arranged' resolution process. In both types of processes, the plan is required to be approved by the Court. In addition to this, the US Bankruptcy Code permits the debtor to sell all or substantially all its assets prior to confirmation of a re-organization plan.

4.3) Types of Pre-Packaged Insolvency

4.3.1) Pre-Packaged Insolvency Resolution Process (PPIRP)

In this process, the debtor appoints an Insolvency Resolution Professional (IRP) who would negotiate with interested parties, potential investors or new creditors and then take approval of proposal from Committee of Creditors (COC) constituted by IRP under supervision of NCLT/ AA. Once the COC gives its go ahead the approval should be taken from court/ adjudicating authority (AA). Only after approval from NCLT/Court the CIRP process would be initiated under section 7,9 &10 of IBC.

4.3.2) Pre-Arranged Insolvency resolution process (PAIRP)

Here the process is similarly conducted by Insolvency Resolution Professional (IRP) but due to confidentiality or secrecy regarding proposed buyout or investment proposal, the IRP doesn't take approval from committee of creditors (COC), and directly take approval from Adjudicating Authority (AA).

In case of India, this type of Pre-Pack insolvency is suggested, since due to preponderance of proprietorship or family driven enterprise, there are always hesitation in sharing info about pre negotiation & debt restructuring among wider class of creditors or interested parties as it may well lead to internal sabotage and disruption of ongoing deal/discussion.

4.3.3) Pre- Arranged Sale (PAS)

Here also an independent Resolution Professional (IRP) is appointed but the debtor negotiates with prospective investor or buyer for outright sale of asset of the company. In a pre-arranged sale, the insolvency professional would conduct a sale of all or substantially all assets of the corporate debtor during the pre-commencement stage without requiring the prior approval of creditors. This process is meant to expedite/ dispose off or sale of specific properties of debtor to payoff any outstanding liabilities.

4.4) Advantages of Pre-Packaged Insolvency

4.4.1) Saving Expense and Time

The pre- packaged Insolvency model ensures that prior to initiating CIRP under Section 7, 9 & 10, the corporate debtor would negotiate a settlement, deal or sale of business with identification of bidders etc. Further, this pre negotiated insolvency package with either resolution or

liquidation need to be approved by Committee of creditors (COC) & Adjudicating Authority (AA). The process of entering and exiting a CIRP is smoother, with creditors onboard with a reorganization plan beforehand. In addition, the company can avoid some of the negative publicity that results from a longer drawn-out bankruptcy process involving creditors fighting for their claims Since everything is done before filing of case, hence the CIRP process becomes smooth with less time consumed and expenses incurred.

4.4.2) **Swift resolution after initiation of CIRP**

Usually in the IBC proceedings, the debtor get maximum of 330 days (180 days + 90 days + 60 days) of protection from recovery of its dues in any way and in case of any big level dispute, the litigation delays such resolution process. The courts, in some cases, has to exclude the time lost in litigation from the maximum period for concerned parties to agree on a resolution plan. But, in pre-packaged insolvency, the case would reach the adjudicating authority after the parties have agreed on the resolution scheme to get it enforceable as soon as possible.

4.4.3) Limiting the damage to corporate debtor

When a CIRP is initiated against a Corporate Debtor, it may be disruptive or harmful to key constituencies, such as customers, employees and suppliers etc. But when a binding support has already been taken to support the plan, the Corporate Debtor faces significantly less harm or disruption as a result of such initiation of the process.

4.4.4) Debtor in Possession business restructuring (DIP)

In contrast to most other business restructuring being initiated by financial creditors i.e banks, NBFC & homebuyers etc, Pre- Packaged Insolvency is a debtor driven business restructuring. In this case, the corporate debtor negotiates or pre arranges with potential investor or buyer for sale of stake or lending.

4.4.5) Business continuity & long term health not impacted

Since this process ensures pre-negotiated stake sale, asset transfer or funding from known & friendly party, hence there is no disruption or permanent damage to the health of company.

4.4.6) Ensures fair and optimum going concern value of business

Since this process is initiated after detailed discussion and understanding about business model, profitability, cash flow, growth and future value addition etc hence the debtor is able to negotiate & extract fair and optimum transaction / enterprise value out of the deal.

4.4.7) No chance of hostile & conflicting buyout

This process is initiated after prolonged discussion & negotiation with the buyer/ investor; hence there is strong understanding about business process & long term vision. Under these circumstances, there is no possibility of hostile or conflicting buyout.

4.4.8) Prior court approved process

Pre Packaged Insolvency is initiated after approval from COC & adjudicating authority, hence there is a strong credibility and sanctity attached to the entire restructuring process.

4.5) Disadvantages of Pre -Packaged Insolvency

4.5.1) Lack of Transparency

Whilst there are advantages to be gained from the nature of pre-pack, looking at the process from an unsecured creditor's perspective, the lack of transparency (the process can be concluded without any creditor or Court approvals) within the pre-pack process has attracted significant criticism. While surely the unsecured creditor could, regardless of the fact that an Insolvency Professional ("IRP") would take every possible step to ensure that all procedural rules have been

complied with, would always have like to doubt that the arrangement was designed to benefit the directors or secured creditors.

4.5.2) Funding of Working Capital

The directors (if it is them buying) have to find the funds to buy the business. The banks would be most unwilling to fund the business, which is supposed to get into Insolvency process. They also have to get new lines of credit and be able to fund the working capital and that may prove expensive.

4.5.3) Debtor can manipulate the transfer of asset & business to connected party to safeguard personal &business liability

Under this process, it is very much possible that debtor colludes with any outside funding partner, business entity to help him transfer his asset/ business ownership and hence subverting insolvency process & escape debtors obligation and liability etc. In this the role of COC and Adjudicating authority becomes critical.

4.6) Important considerations & prerequisite for a pre-packaged insolvency

4.6.1) For a company considering a pre-packaged bankruptcy, there are two important considerations. The company seeking pre-packaged insolvency must have **sufficient liquidity**. Since the company is proposed to get into CIRP process, hence no bank funding can be expected. The company must have sufficient liquidity to take care for extended period (weeks/months) of negotiation prior to initiation of insolvency process.

4.6.2) Benefit of moratorium against legal action under CIRP. Once the petition under Section 7 or Section 9, is admitted by NCLT, an automatic stay i.e. moratorium will come into existence pursuant to Section 14 of the Code, which prevents creditors from enforcing remedies against the corporate debtor and its assets. This automatic stay / moratorium, prohibits the commencement or continuation of all pending suits or proceedings against the corporate debtor that could have been or were commenced prior to the commencement of the CIRP, which includes execution of existing judgment / decree and any act to obtain possession of property of the corporate debtor or perfect a lien against debtor's property. Hence the existence of moratorium is a powerful protection for the debtor, which forces creditors into a single, organized proceeding, allowing the debtor to concentrate its efforts on a coordinated and holistic restructuring. However, in a pre-packaged bankruptcy, during the period when the company formulates, negotiates and documents the proposed plan, the company does not have the protection afforded by the moratorium, which means that creditors can enforce remedies against the company and its assets at any time outside the insolvency process. To avoid and mitigate any possibility of creditors action during Pre Pack negotiation the corporate debtor will need to communicate regularly with its creditors, maintain its credibility during this period and monitor potential situations that could upset the pre-filing status quo.

4.7) Difference between Pre-Pack & other forms of Debt Restructuring

Pre-Pack Insolvency is a Debtor initiated process (DIP) where the company negotiates with a prospective buyer or investor or creditor as per own terms & condition in the best interest of business. Pre-pack process would follow mutually agreed terms & condition between debtor & resolution applicant, with no link to existing or past credit history**.** In case the debtor company seeks to initiate the pre-pack, it would have to ensure that the necessary shareholders' resolutions and board resolutions have been passed.

Other forms of debt restructuring i.e IBC are creditors driven hence no need of shareholders or board approval, but informal understanding among creditors sufficient. Here everything s driven by regulatory requirement, banks internal lending norm, asset classification norm of RBI etc. In

this case creditors interest is paramount while negotiating any sale of asset or takeover of company or fresh credit support.

4.8) Relevance of Section 29 A- Connected party Pre-packs and Role of Promoters

Section 29A seeks to effectively prohibit buy-backs of assets or business by the existing management of the debtor through another company also defined as connected party. Section 29A defines eligibility of resolution applicant (RA). It also defines the connected parties to corporate debtor, who are not allowed to take part in Insolvency resolution process.

4.8.1) In reference to Pre-Pack Process –As pre-packaged insolvency process is a debtor-initiated process, it is actually a right available to an entity in distress prior to the initiation of CIRP. Thereby, section 29A is not applicable in pre-packaged insolvency.

4.8.2) Post initiation of CIRP -The pre-packaged insolvency is a right available to the debtor to put his distressed company in order before the initiation of CIRP. After the admission of insolvency, the CD is entitled to seek withdrawal or termination of the process with the majority approval of the 90% of the creditors, before EOI stage. After the EOI stage, the compliance of 29A would become imminent as the date of submission of Resolution Plan reaches.

4.9) How does Pre-Packworksin other countries ?

4.9.1) Pre-Pack model in UK

4.9.1.1) Board of Directors of company pass resolution declaring they have considered the current financial condition of the company and see the need of resolution/ rescue via Pre-Packaged Insolvency. That resolution should include appointing an Insolvency Professional to advise the company.

4.9.1.2) The IP reviews the financial position and performance and advises either of these option i.e. 'Carry on business', Company Voluntary Arrangement, Administration (including consideration of a pre-pack sale); and Creditors Voluntary Winding-up.

4.9.1.3) wherever a pre-pack administration is deemed appropriate the IP shall try to identify buyers.

4.9.1.4) Ensure Compliance via the Statement of Insolvency Practice 16, which also provides direction to IP's with respect to any proposed pre-pack sale.

4.9.1.5) Insolvency Professional to evaluate the valuation of company, through help from independent valuers.

4.9.1.6) The Directors to prepare a Statement of Affairs & if connected party is leading the discussion to acquire businesses, they are required to consult with the pre-pack pool of creditors.

4.9.1.7) IP will be appointed as Administrator to affect sale of business &or assets of company.

4.9.1.8) After the sale, an Administrator provides creditors with detailed narrative explanation and justification (the SIP 16 statement) of why a pre-packaged sale was undertaken and all alternatives considered.

4.9.2) Pre-Pack model in USA

The US Bankruptcy Code under chapter 11 recognizes three forms of hybrid proceedings, namely pre-packaged bankruptcy proceedings, pre-arranged bankruptcy proceedings and pre-plan sales. Following are the details,

4.9.2.1) Pre-Packaged and Pre- Arranged Bankruptcies

Pre-arranged and pre-packaged proceedings are considered to be more efficient than both the formal reorganization proceedings under Chapter 11 of the US Bankruptcy Code and pure out-of-

court restructurings. The pre negotiated insolvency proceedings take substantially lesser time(2 & 4 months respectively) for confirmation of courts as compared to any traditional Chapter 11 proceedings, which takes almost eleven month. Further, Pre-Packs are relatively more immune from the problem of hold-outs than out-of-court reorganizations as they provide an opportunity to shut down any plan on minority dissenting creditors.

Following four steps are required as part of Pre-Pack proceedings,

i) Negotiation and Solicitation for Acceptance

Prior to filing a petition before court, the debtor typically undertakes negotiations with interested parties and finalizes the reorganization plan. Subsequent to finalization of plan, the debtor circulates the negotiated plan with claim holders and "**interested parties**" with a view to solicit their acceptance regarding the same. The plan is accompanied by a disclosure statement, the key objective of which is to enable an interested part to make an informed decision on the plan.

In case of pre-arranged filings, even as the debtor negotiates the reorganization plan with some of the major interested parties prior to commencement of formal proceedings, yet the plan is not circulated formally with all the impaired interested parties prior to filing. As a result, the disclosure statement accompanying the plan would require the approval of the Court.

ii) Acceptance of the Plan by Creditors

Chapter 11 plan–including pre-packaged and pre- arranged plans—has to be accepted by every class of interested parties whose rights are impaired by the plan. A class of interested parties would comprise of creditors or shareholders whose claims or interests are "*substantially similar*" and every interested party belonging to the same class should be provided the same treatment under the reorganisation plan.

For acceptance by a class of creditors, the plan should be accepted by "*at least two-thirds in amount and more than one-half in number of the allowed claims*". Once the requisite majority is reached within a class, the entire class is deemed to have voted in favour of the plan, thereby binding the majority decision on all members of the class.

For acceptance by a class of shareholders, the plan should be accepted by at least two-thirds in amount of the total allowed interests of that class. Importantly, class of interested parties whose rights are not impaired by the plan would be deemed to have accepted the planand a class of interested parties, whose members do not receive or retain any property under the plan, would be deemed to have rejected the plan.

iii) Filing before Court

Subsequent to finalisation of the plan—including solicitation of votes and acceptance by impaired classes of interested parties in case of pre-packaged fillings— the debtor may file a voluntary Chapter 11 petition, along with applications for operational continuity (such as post-petition financing, right to use existing bank accounts, cash management systems etc.)

iv) Confirmation of Plan

If the plan has already been accepted by each class of impaired interested parties, the Court would confirm the same if it complies with the requirements laid down in Section 1129(a), which includes requirements regarding the plan and the proponent of the plan being compliant with the following provisions of US Bankruptcy Code, a) the plan being made in good faith and not being forbidden by law; b) acceptance by every class of impaired interested parties; c)every dissenting impaired interested party receiving or retaining an amount not less than what she would have received or retained under liquidation; d) the confirmation of the plan not being likely to be followed by liquidation or further reorganization.

Alternatively, if the plan is not accepted by every class of impaired interested parties, the Court would confirm the plan if it complies with the confirmation requirements of Section 1129 if the plan does not discriminate unfairly and is fair and equitable to each dissenting class of interested parties.

4.9.2.2) Pre-Plan Sales

Section 363 of the US Bankruptcy Code permits the debtor to expediently sell all or substantially all of its assets, without the "*constellation of requirements*" involved in a sale under a typical Chapter 11 reorganization plan. Hence, pre-plan sale is a much simpler, quicker and more certain process than the traditional Chapter 11 procedure. Pre-plan sale requires prior notice to every interested party, to provide them an opportunity to object to the proposed transaction. Typically, at least a 21 days' notice should be provided, to interested parties unless the bankruptcy court, owing to the exigencies of a case, reduces the period of notice. In fact the bankruptcy court has power to approve plan even without approval from interested parties.

5) CONCLUSION

During time of extreme economic distress affecting businesses across verticals, its important to seek resolution through informal mechanism, so that both time & cost is reduced to optimum. Pre-Pack Insolvency has special importance during the period when liquidation is haunting the businesses.

In a situation, when almost entire financial sector is affected by the problem of NPA/ distressed asset, pre-packs may prove to be a useful tool to aid CIRP process under IBC. Such pre-pack transactions however, would have to strictly work within specifically formulated framework, should be vetted thoroughly and approved by specialised adjudicatory bodies which may be set up under the aegis of the NCLT. The proposed functional framework of Pre-Packs must substantially cut down the role of NCLT/ courts in the entire process so as to ensure the voluntary nature of pre packs negotiation.

Initiating Pre-pack insolvency would prove a maturing of debt restructuring, where the interest of debtor and creditors get sychronised and aligned to common objective. This will also prove the effectiveness of out of court settlement process in cases of large debt resolution. This would finally ensure a less or cases being filed under IBC, hence lessening the court burden. The best part is the time & cost associated with debt resolution would get minimized.

For a pre-pack to be successful it is necessary to ascertain the tangible value of the corporate debtor to ensure that a balance is struck between corporate resolution of such company and the use of a pre-pack as a means to avoid excess debts. In order that Pre- Pack becomes successful its important to initiate aggressive marketing of distress assets, calling for expressions of interest(EOI) from parties interested in taking over the business / assets of the debtor company by asking bidders to quote their price for such assets.

It is pertinent to note that in the judgment, Lokhandwala Kataria Constructions Pvt Ltd Vs Nisus Finance and Investment Managers LLP, the Supreme Court used its power under Article 142 of the Constitution to give its approval for out of court settlement for the benefit of all the stakeholders and for meeting the ends of justice. Furthermore, many cases before the NCLT or the corporate insolvency resolution process CIRP) have resulted in liquidation primarily because of absence of a proper resolution plan. This proves the need for a legally sanctioned out of court settlement process as the need of the hour.

In view of the multiple benefits of Pre-Packs as also the ease of implementation as explained in detail through this article, the author believes this idea of pre-packaged insolvency,is worth to be implemented in India, in order to achieve the larger goal, objective &benefit from IBC.

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